THE HARRIMAN INSTITUTE

FORUM

Volume 3, Number 2 *February, 1990*

Foreign Investment in the USSR

by Sarah C. Carey

The Soviet Union today faces a huge demand for capital to pay off its growing deficit, to modernize industry, and to satisfy consumer requirements. To meet this demand, Soviet policy makers are exploring a range of options that include the sale of bonds, the lease or privatization of a variety of state-owned properties, and dramatic cuts in defense spending. In addition to these potentially far-reaching measures, it is likely that a significant percentage of capital requirements will be met by foreign trade and investment. Soviet economist Nikolai Smelov estimates that over the next decade foreign trade and investment (along with cooperatives and small family businesses) will comprise thirty to forty percent of the Soviet economy.[1]

The USSR offers vast and varied natural resources, an educated population and comparatively low production costs. If it can assure adequate economic stability and a good return on investment, it should become a desirable market, particularly as investment vehicles expand. At present the only way that foreigners can invest in the Soviet Union is through joint ventures, or, on a smaller scale, as members of cooperatives. In the next few years a steady expansion of investment opportunities can be anticipated, with foreigners participating in long-term leases of land and other property, as stockholders of Soviet businesses, in special Western-organized investment funds designed to finance new businesses in the Soviet Union, and in Soviet bond offerings, currency auctions, and other financial markets. The rules governing such participation can only be conjectured at this point, but there is little debate that the scope and configuration of foreign investment in the USSR will continue to expand.

Emerging Investment Opportunities

Western investment was encouraged in Russia during the last three decades of the tsarist regime, as it was during certain periods immediately after the revolution. Stalin abruptly cancelled this policy in the early 1930s,[2] and the USSR remained a highly protected, autarkic economy until the late 1960s. During the 1970s some erosion of this protectionism occurred, with the inclusion of large scale "compensation" agreements with Western firms, particularly in the chemical industry. Under these arrangements, Westerners constructed large manufacturing complexes, receiving payment in the resulting product. The Western investor did not have an ownership interest in the factory, but did have a contractual claim to a defined percentage of its production.

In January 1987, as part of Gorbachev's overall plan for economic restructuring, the Soviets announced dramatic changes in the organization and conduct of foreign trade and investment. A series of policy pronouncements and Council of Ministers' decrees signalled a new Soviet commitment to making the ruble convertible and to becoming a significant player in international markets, including seeking membership in the GATT, the IMF, the World Bank, and other international trade and financial organizations. In addition,

1 Interview in *BLOC Magazine*, premier issue, 1989, p. 29.
2 During the early stages of Soviet economic development, for example the period of 1889-1913, foreign capital (primarily from France, England and Belgium) accounted for roughly forty percent of industrial development and fifteen to twenty percent of total investment. During the NEP period (1921-1928), foreign concessions were granted and credits from the capitalist world were sought but foreign trade did not reach pre-revolutionary levels.

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a gradual abolition of the Ministry of Foreign Trade's monopoly over export and import activity was announced, culminating in April 1989 in the granting of authority to all enterprises and production cooperatives to trade with foreigners directly. The banking system was reorganized, again with a proliferation of new players, a number of which have the right, with Vneshekonombank's permission, to engage in foreign trade. Most important, the Soviets reversed their long-standing ban on foreign investment by inviting foreign participation in joint ventures.[3]

Under the new joint venture laws, as amended, a Western company may own ninety-nine percent (probably one hundred percent) of an enterprise (the joint venture) in the USSR, may designate the chairman of the joint venture or its general director, and may play a dominant role in management decisions. The joint venture may engage in virtually any legitimate business activity not reserved to the state. Joint ventures are in operation or being negotiated in virtually every industry (except the military), in localities previously closed to foreigners (such as Kamchatka, Vladivostok, and Magadan), with partners that previously operated exclusively in the military sector (for instance, the Ministry of Medium Machine Building), and in sectors previously controlled by state monopolies (Intourist, Minsviaz, etc.).

The joint ventures in the process of negotiation touch virtually every facet of the Soviet economy. Although cumulatively they are small in terms of total investment, their significance is considerable because of their competitive impact. For example, one has only to visit the Hotel Savoy, a Soviet-Finnish joint venture, to see that it sets a new standard for Moscow hotels. And it is no coincidence that Minpribor (the Ministry of Instrumentation) was abolished a year after two joint ventures were established for the distribution of process control systems, products that previously fell under Minpribor's jurisdiction.

The joint venture law is an experiment — a first, closely-observed step in a continuum that, in the next five years, will undoubtedly result in diversified foreign investment opportunities in the USSR. One new opportunity — the creation of free economic zones offering special concessions and incentives to encourage economic development — was announced two years ago.

In addition to the zones, which are largely motivated by a desire to increase foreign investment, many of the major reforms directed primarily at the domestic economy will also be open to foreign participation. One such reform currently being discussed by the Supreme Soviet is the right to execute long-term leases for the use of land, farms, factories, capital equipment, transport vehicles, and a host of other assets (leases of fifty years or longer have been proposed; some policy-makers are talking of ninety-nine years).[4] According to a current draft of this law, in certain circumstances the lessee may obtain title to the leased property upon expiration of the lease (assuming the fees paid cover the cost of the property).

The Supreme Soviet is also heatedly debating the issuance of bonds to finance the national debt and stocks to finance new economic development.[5] In December 1988 it authorized a system of currency auctions. These auctions are now open only to Soviet enterprises, but they allow hard currency to be traded for rubles at market rates defined by the auction participants. A trial auction was conducted in March 1989, followed by a full-scale auction in November 1989, with promises of regular auctions to come. The ruble traded for ten to a dollar at the first auction and fifteen to a dollar at the second.

Recently, the Supreme Soviet gave cooperatives the right to buy out failing state enterprises — and since a foreigner may be a cooperative member, he may end up owning a piece of an enterprise. Although enabling legislation has not yet been proposed, there is serious discussion on legalizing the dollar (thereby permitting the circulation of two currencies), issuing gold-backed bonds, and backing the ruble with gold reserves or other valuable resources, all as a fast track to convertibility.

Although the labels are different, Soviet policy makers are seriously considering the creation of a range of new financial instruments and the sale or "privatization" (primarily through the lease vehicle) of a range of state properties. The question of whether and at what levels foreigners will be permitted to participate in these markets remains open. Investment initiatives are also being launched from the West. At least one USSR venture fund has been announced[6]

Soviet borrowing and investment activities in the West can also be expected to expand. This activity will stimulate new relationships between Soviet and Western investors and

3 January 1987, Decree No. 49 of the USSR Council of Ministers, "On the Establishment in the Territory of the USSR and Operation of Joint Ventures with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries"; September 1987, Decree No. 1074 of the USSR Council of Ministers, "On Additional Measures to Improve Foreign Economic Activity in the New Conditions of Economic Management"; December 1988, Decree No. 1045, "On Further Development of the Foreign Economic Activity of State, Cooperative, and Other Public Enterprises, Amalgamations, and Organizations"; and March 1989, Decree No. 203 implementing Decree No. 1405.

4 Finnish interests are already negotiating long-term leases in the northwest USSR, and Japanese interests are reportedly doing the same in the Far East.

5 Soviet Minister of Finance Pavlov has stated that the government plans to introduce "enterprise shares" — cross shareholdings held by one enterprise in another that eventually could be traded on a stock exchange. The Soviets also plan to authorize the issuance of workers' shares in their own factories that initially could only be resold to the enterprise. (*Financial Times*, August 4, 1989, p. 1.)

6 The Soviet American Venture Capital Firm has been established to finance start-up Western ventures in the USSR (*Journal of Commerce*, October 21, 1989, p. 4A). The creation of an Environmental Fund composed primarily of contributions from Soviet polluting industries and supplemented by Western contributors is also under discussion. This fund will invest in high growth Western stocks and will provide low cost loans to new Soviet joint ventures that produce environmental cleanup products.

money managers that will, in turn, result in a continuing expansion of investment opportunities in the USSR.

Although until recently the USSR has been a minor participant in world money markets, operating largely through state organizations, the level of investment and the players are expanding. At the beginning of the year, the USSR's foreign debt stood at thirty-three billion rubles, including twenty-eight billion rubles in freely convertible currencies, or fifty-three billion dollars; these borrowings were concentrated largely in infrastructure development, with the balance accounted for in trade loans. Soviet economists say that the USSR will require an infusion of more than sixty billion dollars in foreign capital and investment over the next five years to help meet the short- and medium-term goals of *perestroika*, including a sharp increase in imports of consumer goods.

The Soviets, in addition to seeking Western capital, will accelerate investment in the West as a result of Decree 1074, "On Additional Measures for Improving Foreign Economic Activity Under New Management Conditions." This law encourages state enterprises to consolidate their funds for purposes of investing in Western financial markets. It also calls for new training and academic study programs to prepare personnel "for participation in foreign stock market ventures" and "investment activities abroad."[7]

The following pages examine the Soviet experience with joint ventures over the past few years, treating those ventures as a microcosm of foreign participation in the economy. Some emerging investment opportunities are also discussed.

Joint Ventures

The Soviet joint venture experiment, the first major effort to encourage foreign investment, is now almost three years old. The progress to date in terms of the number of businesses created and the total level of capital investment is not dramatic. However, the experiment in new forms of doing business and foreign ownership in the USSR is significant, paving the way for more extensive reforms.

As of October 1, 1989, almost 950 joint ventures had been created in the USSR with a total Western direct investment of around 1.49 billion dollars. Over ninety-five of these were with US firms. Most of the Western capital contributions came in the form of transfers of machinery and equipment, know-how, patents, etc., with the cash contribution constituting only twenty to thirty-three percent of the Western investment. By far the largest number of new enterprises focused on business or engineering services, and on the production of personal computers and computer programming. Considerably fewer were in manufacturing. By the end of 1989 it is expected that another 250 to 350 joint ventures will be registered. The 1989 experience suggests a gradual increase in the confidence of Western investors as well as the greater complexity of negotiating manufacturing ventures.

Joint ventures exist or are being negotiated in virtually every sector — hotels and tourism, entertainment, publishing, computers and software, telecommunications, environmental protection products, food processing, energy and natural resource extraction, health care and hospitals, transportation, mining, etc. Among the major joint venture projects recently concluded or currently under discussion are: The Combustion Engineering-Neste Corp. (Finland) petrochemical joint venture with the Ministry of Chemical and Oil Refining Industries in Tobolsk, Western Siberia; Occidental Petroleum's six billion dollar petrochemical project on the Caspian Sea, as well as its two polyvinyl chloride plants in the Soviet Ukraine valued at two hundred million dollars; the Japanese paper-pulp complex with an annual capacity of two hundred thousand tons in Sakhalin; and the consortium telecommunications project recently announced by US West (including British Telecommunications, Denmark's Denwa, Australia's OTC, Italy's Sovieta Finanziaria Telefonica PA and Denmark's Telecom) to construct a trans-USSR fiber optic cable that will be connected with international cable systems in both Europe and Asia. The American Trade Consortium (a group of US companies joining together to pool hard currency earnings and other resources) states that by 1990-1991 it will have at least twenty-five joint ventures officially registered that collectively are expected to generate five to ten billion dollars over the next fifteen years. These projects, and many others of lesser scale, demonstrate the diversity of Soviet joint ventures and their broad penetration of the economy.

The process of negotiating joint ventures and the operating rules that govern them are now clearly established. The joint venture's governing board is free to set the policy for virtually all aspects of its business operations, including import and export practices, production targets, pricing policy, distribution systems, and personnel policy. It is not subject to the control of various Soviet state organizations that regulate the domestic economy, such as Gosplan, Gosnab, Goskomtrud, and Goskomtsen.[8] Joint ventures have some independence in meeting their needs for insurance, banking, and accounting services, although in each of these areas certain basic Soviet requirements must be met. And once its core activity is approved, a joint venture is permitted to engage in a range of other activities, such as trading in unrelated products, or real-estate development, particularly if those activities are necessary to generate the

7 See also USSR Council of Ministers Decree No. 412, May 18, 1989, encouraging the creation of Soviet organizations abroad to, among other things, trade in foreign stock exchanges.

8 The joint venture does, however, have to conform with regulatory requirements designed to protect the public, such as workers' safety, consumer protection, public health, environmental and other rules.

hard currency required to meet obligations to its Western partner.

The major problems confronting joint ventures derive from the transitional, unstable nature of the Soviet economy and not from the joint venture regulations themselves. Problems are also caused by the avalanche of new Soviet laws already passed or in deliberation that impact all aspects of commercial activity. For example, since 1987, in addition to the overhaul of foreign trade described above, the role of industrial ministries and state regulatory bodies has been re-defined, resulting in a transition from an operational to a norm-setting or regulatory role (several ministries have been abolished). At the same time, state enterprises have been given greater independence and new responsibilities. New business forms have been created — cooperatives, joint stock companies, and individual proprietorships. The laws defining intellectual property rights, the banking system, taxation, and the rights of workers have also been rewritten. In addition, basic concepts of property and ownership are being re-defined, as are "intergovernmental relations" — the balance of power between the central government and the republic and local governments, with new tax and other powers devolving to the localities.

The key problem areas for Western joint venture partners created by this avalanche of change include the difficulty of getting paid in hard currency (due to the non-convertibility of the ruble), the inability to insure adequate suppliers and customers due to the vagaries of the Soviet distribution system, the inability to obtain adequate financial or performance guarantees, and the confusion caused by the decentralization of governmental and commercial decision making.

Getting Paid — The Convertibility Problem

A number of major corporations are deciding to enter the Soviet market for the long haul, positioning themselves for the day when the ruble will become convertible. The Soviets have declared this to be a key policy objective and Minister of Finance Pavlov has projected convertibility by the year 2005. In the interim, these companies are willing to accept their share of joint venture profits in rubles and to invest them in expansion of the joint venture or in other businesses in the USSR.

Other Western companies do not have a serious problem because their primary investment objective in the USSR is to secure access to raw or semi-processed products. This group includes companies whose primary focus is the development of natural resources, such as oil, copper, gold or timber. These companies are perfectly willing to take payment in the resource produced, in either raw or semi-processed form, and to resell it in hard currency markets. In a striking development, the Soviets are opening up virtually all of their natural resources to foreign participation. The challenge to the foreign company involved in natural resource development is twofold: to construct a fair arrangement that permits the Soviets adequate control over, and rewards for, their natural wealth, and to meet increasingly stringent local environmental requirements.

A number of Western companies are involved in projects that sell products or services to the international community for hard currency. This category includes the hotel and tourism industry, engineering or environmental consultants working on Western projects, and some aspects of the telecommunications industry.

The Western investor also overcomes the convertibility problem where the joint venture produces a percentage of its output for export to hard currency markets. Many joint ventures allocate part of their output to markets, agreed upon by the partners, that are not in competition with the already established markets of the Western partner. Others produce specific components or "contract" products for sale to the Western partner, which incorporates them into its global manufacturing or marketing operations (for example, valves for process control systems). Still other joint ventures, in addition to the finished products produced for the Soviet market, manufacture semi-processed materials that are marketed in the West, such as intermediate chemicals or wood chips for pulp.

The final mechanism for generating hard currency is countertrade or switch trading. The Soviet joint venture rules permit the Western joint venture partner to accept payment in products unrelated to the joint venture's production or to purchase such products with its ruble profits. These goods, which ordinarily would be available only for hard currency, can then be sold to trading companies that in turn distribute them through their regular channels. Trading houses, in growing numbers, are becoming expert in these transactions.

Together these approaches can support billions of dollars in trade. However, for every solution to the ruble dilemma that is developed by joint venture partners, at least as many joint ventures fail in the negotiation process because of the Western partner's inability to get paid in hard currency. To address this problem, at least one prominent Soviet economist has proposed that the Soviet government guarantee convertibility for joint ventures.[9]

Absent such guarantees, further problems for joint ventures may be created by the proposed establishment of a three-tier system of exchange rates, along with a significant devaluation of the ruble. The three-tier rate contemplates one rate for non-commercial transactions such as travel and certain services, introduced in November 1989, a second rate

9 This suggestion has been put forward by the Soviet economist Stanislav Menshikov, who has also proposed the joint ventures be granted a tax exemption for ten years (*New York Times*, September 22, 1989, p. D2.)

for transactions involving manufactured goods (to be introduced in January 1990) involving a fifty percent devaluation of the ruble from its current exchange rate, and a third rate applying to transactions involving energy and raw materials. This will be a devaluation to about R0.85=$1. A unified commercial exchange rate may be introduced in early 1991, further devaluing the ruble to R2.00-2.50=$1. Among other impacts, the devaluations will create a hardship for those joint ventures that manufacture products for the Soviet market and that rely on components imported for hard currency.[10]

Distribution Problems

Untangling the Soviet distribution system — with its mixture of wholesale trade, contract trade and "state orders" administered by the industrial ministries — is a real challenge. Solutions to the inefficiencies and contradictions of the system are elusive. Initially, manufacturing joint ventures sought to ensure the delivery of supplies sourced from the local market, as well as the distribution of the joint venture's output via guarantees from the Soviet partner's parent ministry. With some notable exceptions, these guarantees proved difficult to obtain. Equally important, they may be impossible to enforce as the ministries' powers are reduced.

The most viable solutions to the problems of the Soviet distribution system can be found at the local level in the form of long-term supply commitments from Soviet manufacturers and output commitments from potential customers. Some joint ventures are seeking to include suppliers and/or major customers as partners on the Soviet side or even to create their own distribution systems. For the short term, Western investors can achieve the greatest security by "walking on both sides of the street" — betting on the past by seeking ministerial or higher level guarantees, while at the same time betting on the future by negotiating firm contracts at the local level.

The Elusive Guarantee

Besides guarantees of supplies and markets, Western businessmen and bankers are also seeking performance and financial guarantees. Westerners involved in some of the major resource development projects in the Soviet Far East, for example, have sought guarantees that have the full faith and credit of the Soviet state, their reasoning being that the state, in large part, will determine the success or failure of the project. Such a guarantee can only come from the Soviet Council of Ministers and will not be given readily.[11]

A number of bankers have sought more modest guarantees from the organizations whose purchases they are financing. For example, a Western bank financing the sale of ships to Sovkomflot, a new Soviet joint stock company with many of the attributes of a Western corporation and with jurisdictional ties to Minforflot (the Ministry of the Merchant Marine), raised the question of who could provide adequate guarantees. After extensive research, it was concluded that although Sovkomflot's charter, issued by the Council of Ministers in 1989, states that it owns its property, there is no generic statute defining the attributes of companies such as Sovkomflot. In the absence of such a statute, the Merchant Marine Code (passed by the Supreme Soviet and therefore of higher level than the Council of Ministers' approved charter) prevails. The Code states that all Soviet ships belong to the state. This means that until a new corporate law defining the attributes of joint stock companies such as Sovkomflot is passed, Sovkomflot cannot pledge its major assets. Similarly, its parent ministry cannot provide the sought-after guarantee because it has no resources other than the normal office and other equipment required for running a government agency. This leaves only Vneshekonombank, a party not directly involved in the transaction and one that has tremendous discretion to decide whether or not to participate.

The lesson to be derived from this example is that as the Soviet economy moves from a centrally-controlled, government-administered economy to a more decentralized, privately-controlled model, guarantees will be difficult to obtain and enforce. This will result in makeshift efforts to secure other forms of contractual commitments from Soviet parties involved in the transaction. Where the joint venture in question is one of political significance because it responds to a top priority of Soviet economic planners, it may be possible to secure special commitments from superior organizations. Soviet policy-makers recognize that problems caused by the failure to harmonize new experimental economic laws with traditional civil code provisions creates contradictions and uncertainties that discourage foreign investment. To overcome these problems, at least until the massive volume of economic laws currently being drafted is finalized, Soviet politicians appear willing to make extraordinary commitments that they will honor in order to avoid political or economic embarrassment.

Decentralization of Decision-Making

New Soviet laws are redefining the powers of regional and local governments and are also giving local enterprises new decision-making authority. In meetings with Soviet businesspeople from such diverse areas as Karelia (on the

10 *PlanEcon Report*, Vol. V, No. 41, October 13, 1989.

11 At least one project has received guarantees from a republic Council of Ministers, an avenue that offers promise for the future as the republics become increasingly involved in economic activities.

border of Finland), the Primorski Krai (on the Pacific Coast), and Tashkent (the capital of Uzbekistan in Central Asia), we have found that both local government officials and local businessmen are eager to exercise their new authority and are urging Western businessmen to deal directly with them rather than through the center. In certain industries such as agriculture, the central ministry (Gosagroprom) has been dissolved and the action is truly at the local level.

This creates a range of problems for joint ventures. For example, the joint venture decrees define two kinds of taxes — a tax on venture profits and a withholding tax on repatriated profits. At least for the first two years these were interpreted by Soviet authorities to be the only taxes applicable to joint ventures. Recently, a value added or turnover tax has been applied to those joint ventures that produce retail products and it is inevitable that as local and republic governments exercise their new taxing authority, whether as a direct tax on income or a tax on the use of natural resources, joint ventures will not be immune. In anticipation of this problem, some joint ventures have begun to make "voluntary" contributions to local governmental entities.

Initially, Western investors in joint ventures negotiated almost exclusively with the parent ministries for the industries in which they sought to invest, allowing those ministries to designate the actual business partners. Even when manufacturing was involved, the Western side paid little attention to local government authorities or to local political groups, such as environmental organizations, and did not focus on the characteristics or capabilities of its ministry-designated partner until late in the negotiating process.

Today the picture has changed radically. It is now impossible to negotiate or obtain approval for a manufacturing joint venture without the strong support of local authorities, including the approval of the local and/or regional environmental organization. Western businessmen are also realizing that they must take the initiative in selecting their business partners, weighing the competing strengths of potential partners. Finally, individual republics are beginning to enact their own laws, which in many areas impose requirements or establish standards that exceed the national norms. This development requires careful initial research regarding local regulations and incentives.

Foreign Economic Zones

The zone concept is one that promises to attract significant and diverse foreign investment. For over a year, Soviet policy-makers have been drafting concepts for free economic zones and have visited similar zones in the PRC and elsewhere. Enabling legislation can be expected in early 1990.[12] As presently conceived, a generic enabling law will be enacted, to be followed by individual decrees approving specific zones in regions where the local population has voted to develop one. To date, local initiatives have passed in both Vyborg and Nakhodka.

The Soviet zones will not be confined to coastal areas, but will extend to the interior. They will give as much focus to economic development and to the development of necessary imports for the regions where they are located, as to the generation of exports. Zones in different locations will have different development focuses (e.g., development of natural resources in the Far East, of tourism, electronics, and dairy farming in Novgorod, and of high-tech products near Leningrad).

The concessions and incentives that are available to companies participating in a zone will apply to distinct geographic areas designated as zones. They may also apply to individual projects, regardless of location, that meet zone criteria. A broad range of concessions and incentives will be made available, including significant tax and rent discounts, the creation of a special currency such as a gold-backed ruble transferable both internationally and among zones, preferential customs treatment, freedom to experiment in regard to management and employment practices, and relative financial independence. Foreign companies can establish fully owned subsidiaries in the zones. The central government will finance initial construction for zone infrastructure in locations of "national or republic significance." State orders, at least to some extent, will insure markets for zone output.

According to the latest concept paper, zones may be initiated by the central government, the regional government, or a group of foreign corporations. Each zone will have "the authority of a national ministry" in its economic relations with the central economic organs of the USSR. Internally, it will have the power to pass its own laws. The businesses participating in the zone are expected to participate in its governance, presumably through some sort of advisory committee structure.[13]

A number of key questions regarding the structure of the zones remain unanswered, such as the relationship of the zone to the rest of the Soviet economy or the level of state subsidy for infrastructure construction. Nonetheless, Western companies are already pursuing zone projects. Finnish interests are pursuing a zone near Vyborg and are negotiating the lease of land for that purpose, and Japanese interests are doing the same in the Primorski Krai.

At least one US group of companies is negotiating with regional authorities regarding the terms and conditions that will govern a zone in the Soviet Far East. These US companies have been accorded an extraordinary reception by local officials as they develop plans for converting the Nakhodka military airport to civilian uses, for launching a Nakhodka-Japan shuttle air service, for designing a modern

12 The free trade zone is not a new concept. Odessa had such a zone in the last century, and it played a substantial role in that city's development.
13 Concept paper, Spring 1989, USSR Commission on Foreign Economic Ties.

telecommunications gateway to connect zone commercial activities with Asia, and for other infrastructure projects. At least symbolically, the US companies have been heartened by the proposed renaming of the Bay of Nakhodka to "America Bay."

How to Acquire State Property

In recent months, the Supreme Soviet has had under discussion a draft law to permit the leasing of a broad range of assets, including the property of collective farms and state enterprises, individual buildings, equipment, means of transport, livestock, "and other material values." According to these discussions, the duration of a lease may be "from five to fifty years or even longer and is subject to renewal." In at least some instances, the lease is viewed as a "financing lease" where the lessee ends up owning the property upon the termination of the lease. Such leases can be passed on through inheritance practices and can be pledged as security on loans.

The wording of the law currently under discussion describes eligible lessees as "*sovkhozes*, *kolkhozes*, or other state cooperative or other social enterprises (organizations) including organizations of lessees, collectives of their subdivisions, or else a citizen or group of citizens."[14] This would appear to include joint ventures involving foreigners. As noted above, the Soviets are already allowing groups of foreigners to negotiate long term leases of land, at least in the context of free economic zones.

The law on leasing, because of the long-term nature and other attributes of the leasehold interest, opens up dramatic opportunities to Western agriculture interests, developers of office and commercial property, and others. As long as the holder of the lease controls the property, these investors do not care if formal title resides in the state.

Malta and Beyond

Foreign and particularly US investment in the Soviet Union today is minimal. The instability of the economy, the lack of adequate guarantees and the lack of certainty in the legal regulation of commercial activity, along with pre-Malta discriminatory US policy towards trade with the Soviets, are all deterrents to US investors. The Soviet economic system remains highly regulated, with the center still having significant power to determine the success of many economic opportunities that are labelled private. The investment opportunities available to foreigners also remain limited.

However, the trend lines toward new financial instruments, expanded avenues of investment, and a reduction of the role of the state in the economy are positive and accelerating. Further, the openness of Soviet policy-makers and businessmen to the advice of foreign economists, business executives, regulators, and others is producing extensive collaboration that will encourage a gradual but continuous increase in foreign investment. The shift in US policy articulated by President Bush after the Malta Summit should also be an impetus for increased trade and investment.

Given the right Soviet policies, foreign investment will continue to grow. Furthermore, if the ruble becomes convertible, if the Soviets issue a gold-backed ruble, or if Western joint venture partners are guaranteed the right to repatriate their profits — all of which are under discussion — the rate of investment will accelerate dramatically. It is difficult to predict at this stage who will be the major beneficiaries. Immediate neighbors such as the Japanese or the West Germans are logically the major investors in the USSR. But these patterns will depend, in large part, on the relationships that the Soviet Union carves out with the European Community, the ASEAN countries, and other trading blocs.

In any event, there is no question that a year from now foreign investment activity in the USSR will present a much different profile than it does today, based on the ingenuity of capital-hungry Soviets and of Western investors with extensive experience dealing in other regions of the world where currencies are blocked, inconvertible or constantly being devalued.

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Note: For reasons of readability, *The Harriman Institute Forum* now uses the transliteration system of the U.S. Board on Geographic Names.

14 "USSR Supreme Soviet Presidium Decree on the Lease System and Lease Relations in the USSR," *Pravda*, April 8, 1989 (FBIS).

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The Harriman Institute Forum is published monthly by
The W. Averell Harriman Institute for Advanced Study of the Soviet Union, Columbia University
Editor: Paul Lerner
Assistant Editors: Lolly Jewett, Jeff Zelkowitz

The Forum is supported in part by a grant from the Carnegie Corporation of New York.
ISSN Number: 0896-114X.
Subscription information: In the United States or Canada: $30 per year ($20 per year for personal subscription by personal check). Outside the United States and Canada: $40 per year ($30 per year for personal subscription by personal check). Make check or money order payable to Columbia University and send to *Forum*, The Harriman Institute, Columbia University, 420 West 118th Street, New York NY 10027.
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